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March 21, 1995

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Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Ex Parte Notice
CMRS Equal Access and Interconnection
CC Docket No. 94-54

Dear Mr. Caton:

On March 20, 1995, Cox Enterprises, Inc. ("Cox") met with the Chief of the Wireless Telecommunications Bureau, Regina Keeney, to present the enclosed paper by Dr. Gerald W. Brock entitled "Incremental Cost of Local Usage." Dr. Brock, Alexander Netchvolodoff, Cox's Vice President of Public Policy, Werner Hartenberger of Dow, Lohnes & Albertson and the undersigned were present at the meeting. A copy of the paper is attached to this letter.

Dr. Brock's research expands on a Cox policy paper also attached to this letter that advocates Commission adoption of inter-carrier mutual compensation arrangements on a "bill and keep" basis. Please contact the undersigned if any questions arise regarding this matter.

Respectfully submitted,

Laura Phillips

Laura H. Phillips
Counsel for
Cox Enterprises, Inc.

LHP/css
cc: Ms. Regina Keeney

INCREMENTAL COST OF LOCAL USAGE

Gerald W. Brock
March 16, 1995
Prepared for Cox Enterprises

Summary

A reasonable estimate of the average incremental cost of local usage (and therefore the cost of terminating traffic received from a competitor) using digital technology is 0.2 cents per minute. That estimate is based on studies done by or supported by telephone companies. The cost is determined by peak period capacity and therefore the true cost is considerably higher than the 0.2 cents per minute average during the peak period and is zero during the non-peak period.

I. Introduction

In a separate paper prepared for Comcast, I have argued that the theoretically correct interconnection charge is cost based mutual compensation. However, cost can have many different meanings and in a regulatory context, cost based requirements can lead to interminable regulatory proceedings and disputes. Policy makers have consequently frequently sought structural methods of solving problems that do not require detailed oversight of cost rules.

One proposed structural rule is mutual compensation without oversight of actual rates, but as shown in the Comcast paper that approach is inadequate to limit the exercise of monopoly power. An alternative approach that dispenses with direct control of cost is the policy of "sender keep all" or "bill and keep" in which each party agrees to terminate traffic for the other without payment for terminating service. That is equivalent to mutual compensation with a zero price for compensation. It will be economically efficient if <u>either</u> of two conditions are met: (1) Traffic is approximately balanced in each direction; (2) The actual costs are very low so that there is little difference between a cost based rate and a zero rate.

Existing publicly available studies suggest that the incremental cost of local usage (and therefore the cost of terminating traffic from a competitor) is on average approximately 0.2 cents/minute. The actual cost is considerably higher during the peak period and zero during the off peak period. Thus it would not be efficient or desirable to charge at 0.2 cents/minute on a usage basis. However, the very low average number compared to the price currently charged by local exchange companies suggests that far greater distortions are likely from mutual compensation without control of rates than from sender keep all approaches.

There are two basic methods for estimating cost:
(1) engineering studies of the forward looking cost to supply a particular service;
(2) econometric (statistical) studies of the relationship between observed cost and observed outputs.
Both engineering and econometric studies provide useful information on cost. The engineering study allows one to focus on best practice technology and compute the incremental cost of adding capacity to provide a particular function. Econometric studies provide a reality check by using observed output and cost data rather than projections of expected cost. However, econometric studies may produce less precise estimates of the incremental cost of a particular service than engineering studies because they are measuring the correlation between variations in the total cost of different telephone companies and variations in the quantities of particular services provided by those companies. The cost data include costs for different embedded technologies used by the companies and are not precise enough to provide detailed estimates of the incremental costs of particular services with particular types of technology.

II. Engineering Estimate

The most comprehensive public engineering study of incremental cost was done by the Incremental Cost Task Force with members from GTE, Pacific Bell, the California Public

Utilities Commission, and the RAND Corporation.[1] The Task Force had access to data for telephone companies in California and performed a detailed engineering cost study for various output measures of local telephone service. Individual components were priced based on 1988 prices and costs were computed for switch investment, switch maintenance, interoffice transport, and call attempt costs. All costs were computed for calls during the busiest hour of the year because the investment and associated expenses are related entirely to capacity cost. The Task Force computed the following usage costs for each hundred call seconds (CCS) during the busiest hour of the year for "average" and "larger urban" exchanges:

switch investment	$ 5.00 - $ 10.00	per year
switch maintenance	.20 - .50	per year
interoffice calling	.50 - .60	per year
Total	$ 6.00 - $ 11.00	per year

In addition, the task force computed a cost of $ .30 to $.90 per year for each call attempt during the busiest hour of the year and estimated approximately 1.25 busy hour attempts per busy hour CCS.[2]

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1 Bridger M. Mitchell, Incremental Costs of Telephone Access and Local Use, (Santa Monica, CA: The Rand Corporation, 1990); reprinted in William Pollard, ed., Marginal Cost Techniques for Telephone Services: Symposium Proceedings (Columbus, Ohio: National Regulatory Research Institute, 1991) (NRRI 91-6).

2 Ibid., p. 249, 250.

There are 8766 hours per year and the ratio of the peak usage rate to the average usage rate is approximately 3.[3] That implies that one busy hour CCS is approximately equal to 2922 CCS per year (8766/3). Because one CCS is equal to 1.67 minutes, costs per busy hour CCS can be converted into average costs per minute by dividing by 4880 (2922 total year CCS times 1.67 minutes/CCS). Thus the $6.00 - $11.00 cost per year per CCS during the busiest hour of the year translates into $.0012 - $.0023 per minute. The busy hour attempt cost adds $.375 - $ 1.125 per busy hour CCS (1.25 busy hour attempts per buy hour CCS and $.30 to $.90 annual cost per busy hour attempt), raising the total cost, including busy hour attempts, to $6.375 - $12.125, and the per minute cost to $.0013 - $.0025. Taking the middle of the estimated range gives a cost of $.0019 per minute, or approximately 0.2 cents/minute.

Because the cost is determined by the the peak capacity, the actual cost per minute is much higher at the peak and is zero at the off-peak. If, for example, one assumes that an equal size peak occurs for one hour in each business day (260 hours per year of peak usage and 8506 hours of non-peak usage), then the average cost per minute would be 2.1 cents for the 8.9 percent of the traffic that occurs during the 260 peak hours each year and the average

3 Rolla E. Park, Incremental Costs and Efficient Prices with Lumpy Capacity: The Two Product Case, (Santa Monica, CA: The Rand Corporation, 1994), p. 5.

cost per minute would be zero for the 91.1 percent of the traffic that occurs during the 8506 non-peak hours.

A variety of other engineering studies have been done for specific regulatory purposes and submitted to various state regulatory commissions. For example, New England Telephone prepared an engineering study for the Massachusetts PUC that found an incremental cost of 0.2 cents per minute for local usage served by electronic switches, the same as the Incremental Cost Task Force conclusion using California data.[4]

III. Econometric Estimate

Many econometric cost studies of telecommunication have been done, but the procedures used in most of them do not allow an estimate of the incremental cost of local service. One good econometric cost study that does provide an estimate of the marginal cost of local exchange service is the one performed in 1989 by Louis Perl and Jonathan Falk of NERA, using data from 39 companies (24 Bell and 15 non-Bell) over the years 1984-1987. They developed a statistical relationship between the total cost of the individual companies and the access lines, local usage, and toll usage provided by the companies.

Four different models were used for the statistical estimation. In two of the models, the data for each company

4 Reported in Lewis J. Perl and Jonathan Falk, "The Use of Econometric Analysis in Estimating Marginal Cost," in Pollard, Marginal Cost Techniques, op. cit.

was averaged over the four year period to eliminate the effects of minor year to year fluctuations and to provide a pure cross section estimate. In the other two models, observations were used for each company in each of the four years creating a mixture of time series and cross section observations. In two of the models, calls were used as the unit of usage measurement and in the other two calls minutes were used as the unit of usage measurement.

The estimated marginal costs for local minutes ranged from 0.2 cents per minute to 1.3 cents per minute. The costs per call developed in the models using number of calls as the usage unit were divided by the average holding time to produce estimates of cost per minute comparable to the those from the models using number of minutes as the usage unit. The lowest estimate came from the model with only cross section observations averaged over the four years. The highest estimate came from the model using all observations in a pooled cross section and time series and using calls as the unit of usage measurement. All four models had good statistical properties. Although there are various advantages and disadvantages of each of the four models, none of the four can be identified as either the clearly correct approach or an approach to be discarded.

The statistical form used by Perl and Falk generates marginal cost numbers approximately equal to average cost numbers. Thus it should be expected that their estimates will be somewhat higher than the engineering estimates of

marginal or incremental cost. Furthermore, the engineering estimates generated by the Incremental Cost Task Force were developed based on digital switching technology while the Perl and Falk estimate for local minutes served by electronic switches was based on the embedded technology in 1984-87 which was primarily analog. It is likely that the incremental costs of usage capacity for analog switching are higher than the incremental costs of usage capacity for digital switching.

IV. Conclusion

A reasonable estimate of the average incremental cost of terminating traffic using digital switches is 0.2 cents per minute. That estimate is supported by the engineering studies done with data for California and for Massachusetts and by one of the econometric models developed by Perl and Falk. Other reasonable econometric models using embedded cost data produce somewhat higher cost estimates. The cost is determined by peak period capacity and therefore the true cost is considerably higher than 0.2 cents/minute average during the peak period and is zero during the non-peak period.

THE FINAL FRONTIER

The Role of the Federal Communications Commission in Promoting Local Exchange Competition

Cox Enterprises, Inc.

January 1995

INTRODUCTION

Over the past decade, the Federal Communications Commission (the "Commission") has moved aggressively and successfully to bring competition to the interstate telecommunications market. Where a single monopoly carrier once existed, hundreds of interexchange carriers now provide alternative services to customers. The development of competition has led to reduced rates and an ever-increasing variety of services. As a result of its streamlined regulation of nondominant carriers and expanded interconnection policies, the Commission has extended the benefits of competition to interstate access customers.

The Commission also has authorized provision of video dialtone by telephone companies to promote increased competition in the market for cable television. Moreover, the cable television-telephone company cross-ownership prohibition has been overturned by federal courts in states served by 6 of the 7 Regional Bell Operating Companies ("RBOCs"). These events, combined with the presence of free broadcast television and the introduction of direct broadcast satellite services, assure that the promise of competition for multichannel video services will be realized.

There remains only one telecommunications market in which monopoly reigns: the local exchange. In recent years it has become increasingly evident that local exchange service is not a "natural" monopoly. Cable operators and interexchange carriers gladly would invest their shareholders' money to build competitive local exchange systems, but provision of competitive local exchange service has not been authorized in the vast majority of states. Clearly, the time for change has come.

Although the Commission cannot eliminate the entry barriers maintained in so many states, it can implement many policies that promote competition while the states and

Congress move in the direction of urgent legislative reform. Action on all fronts is needed now if the promise of competition in the local exchange market is to be realized.

Cox believes there are nine areas in which reform is necessary to further the goal of local exchange competition:

(1) Preemption of state and local barriers to entry. Competition for local exchange services cannot develop until barriers to entry are eliminated. The most obvious barriers are state laws and policies that grant exclusive franchises to the incumbent LEC or unreasonably condition competitive entry. Until these state laws are preempted, customers will be denied the benefits of competition.

(2) Forbearance of regulation for nondominant carriers. Regulation is necessary only when a company is not constrained by competition. New entrants in the local telecommunications market will compete with entrenched monopoly providers and will have no incentive to charge unreasonable rates or provide low quality service. Consequently, regulation of local exchange providers without market power should be less stringent in order to encourage competition.

(3) Continued regulation of local exchange carriers as dominant carriers. Regulation of incumbent local exchange providers must be a function of their market power and their control over essential facilities. As long as the incumbent LEC maintains control over essential functions such as numbering and interconnection they should be regulated as dominant carriers. Even after these competitive advantages are eliminated, however, regulation as a dominant carrier will be necessary as long as the incumbent possesses market power.

(4) Reasonable interconnection policies. Interconnection of local telephone networks at reasonable rates is critical to local telephone competition. New market entrants should be provided seamless integration with the incumbent's network at rates that do not constrain the economic viability of competing services.

(5) Comprehensive universal service reform. The universal availability of affordable, basic telephone service is an important public policy objective, but mechanisms promoting universal service must be reformed to ensure that this objective continues to be achieved in a competitive environment. The existing system of implicit subsidies for universal service interferes with the development of competition and should be replaced, if necessary, with a system of explicit subsidies that are available to any telecommunications provider willing to provide basic service to customers who are eligible for support.

(6) Number portability. Competition for local telecommunications services will not develop until customers who change service providers are able to retain the same telephone number at the same location. Interim number portability mechanisms, such as remote call forwarding, are a partial solution at best and inferior to true number portability.

(7) Number administration and assignment by a neutral administrator. Numbering policy must be broadly developed and administered in a competitively neutral manner. If a local exchange carrier is able to control the administration and assignment of numbering resources, it can impose costs on its competitors and hinder the development of competition.

(8) Equal access to conduits and rights of way. Exclusive or preferential treatment of pole, conduit and rights-of-way of the incumbent LEC must be eliminated so that new entrants have access to those rights-of-way on the same rates, terms and conditions as the incumbent.

(9) Stated policy preference for customer choice. Increased customer choice should be a guiding principle for all regulators. Federal, state or local regulations that inhibit customer choice should be eliminated and telephone company practices that hinder the development of competition should be prohibited. Only by actively and aggressively promoting competition can regulators create an environment in which consumers will be presented with competitive choices for local telephone services.

Like the Commission, Cox is a strong advocate for reform through federal legislation. A strong federal policy in favor of competition is the most effective method of removing barriers to entry in the local exchange and ensuring that new entrants are not subject to unnecessary regulatory requirements. However, the Commission need not wait for legislation to achieve many of the goals outlined above. Specifically, this white paper focuses on four areas where Commission action alone could advance competition: interconnection, universal service, numbering and regulation of incumbent local exchange carriers. By addressing these crucial issues in a timely manner, the Commission could set an example for other regulators and legislators and create a regulatory environment that would allow competition for local exchange services to begin to develop.

INTERCONNECTION

Without policies that mandate reasonable interconnection to LEC networks, there will be no chance for local competition. New competitors in the local exchange market, such as competitive access providers ("CAPs") and Personal Communications Services ("PCS") licensees, must interconnect with LEC networks if they are to operate, let alone survive, in the telephony marketplace. The Commission must adopt policies that require LECs to provide interconnection to all competitive carriers on an unbundled basis at rates that do not threaten the economic viability of competing services.

The Commission's previous experience with mandatory interconnection requirements demonstrates the likelihood for LEC abuse. The Commission adopted expanded interconnection requirements for special access services over two years ago, yet it still is investigating the lawfulness of the rates proposed in most LEC interconnection tariffs. Moreover, in some cases the Commission has been forced to prescribe interim rates based on its finding that LECs have loaded uniformly unreasonable costs onto their interconnection tariffs in order to thwart the development of competition.[1/]

As CAPs, cable operators, PCS licensees and other potential competitors seek to enter the local exchange market, the potential for LEC abuse, and the need for Commission scrutiny, will increase. Local exchange competition will not be viable if a LEC can impose unreasonable termination or interconnection charges on new entrants. In many

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1/ Ameritech Operating Companies, Order, CC Docket 94-97 (rel. December 9, 1994) (suspending LEC rates for virtual co-location based on a finding that certain rates were unreasonably high).

cases, the pricing, terms and conditions of interconnection will be the dispositive factor in determining whether a company chooses to provide local exchange service in competition with the incumbent. This point is illustrated by the recent decision of SBC Media Ventures to ask the Maryland Public Service Commission to defer considering SBC's application to provide competitive residential service in Montgomery County, Maryland until LEC interconnection rates have been established and SBC is able to determine whether its proposal is economically viable.

Interconnection at reasonable rates also will be essential to the success of PCS and other wireless services. As Cox stated in its comments filed in the pending proceeding on interconnection for Competitive Mobile Radio Service ("CMRS") providers:

> In order for competition to develop, monopoly LECs can no longer control nearly every aspect of the rates, terms and conditions of interconnection. While the Commission has taken a step in the right direction in requiring mutuality of compensation requirements for interconnection, even under that framework LECs can continue to control the development of their competitors. Accordingly, a new policy framework is required.[2/]

The policy proposed by Cox for CMRS interconnection requires active monitoring of LEC interconnection rates by the Commission. Standing alone, a mutual compensation requirement, even if it is nondiscriminatory, is insufficient to prevent LEC

2/ Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services, CC Docket No. 94-54, Comments of Cox Enterprises, Inc. (filed September 12, 1994).

abuses.[3/] Because the LEC network will terminate far more calls than a wireless network, the LEC has an incentive to hold out for an unreasonably high mutual compensation rate. As they already have demonstrated in the expanded interconnection tariffs, LECs will not hesitate to load unreasonable costs onto their competitors' interconnection rates. A simple nondiscrimination requirement will not prevent such behavior because the LEC can "negotiate" an unreasonably high rate with its wireless affiliate and impose that same rate on other cellular and PCS providers. Because a competitive wireless provider cannot effectively provide service to customers without interconnection to the LEC network, wireless providers will be powerless to negotiate reasonable interconnection rates.

One simple and effective interconnection arrangement that could be adopted by the Commission is a "bill and keep" arrangement. Under this proposal, local exchange traffic transferred to a terminating carrier at its last point of switching would be terminated without charge to the originating carrier. Because the number of calls for which termination charges must be paid is vastly reduced under a bill and keep arrangement, the interconnection process is simplified and the potential for anticompetitive behavior is reduced. Even under this proposal, however, carriers should retain the flexibility to negotiate different arrangements and the Commission should continue to monitor

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3/ For example, in its Reply Comments in the CMRS proceeding, Pacific Bell made plain its intention to flaunt FCC rules requiring mutual compensation. See Reply Comments of Pacific Bell at 10 (filed October 13, 1994) (stating that mutual compensation is inapplicable to LECs with respect to interstate traffic and that the FCC has no authority to require mutual compensation for intrastate traffic).

interconnection and, where necessary, to preempt state interconnection policies, to protect against LEC abuses.

UNIVERSAL SERVICE

Preservation of universal service is one of the Commission's primary goals, and the Commission has pursued that goal diligently. Over the years, the Commission has developed a variety of policies intended to maintain reasonable rates for residential service. While this patchwork approach achieved high penetration rates in a monopoly environment, the promise of competition necessitates change.

The current system has two major problems. First, by allowing monopoly LECs to obtain subsidies for "high cost" areas, the current system reduces the incentives for carriers to cut costs efficiently. At the same time, subsidized monopoly services that result in below-cost pricing eliminate the incentive for competitors to enter a market. Consequently, the Commission is faced with a dilemma: While competition requires a shift towards cost-based pricing, cost-based pricing of local exchange service might jeopardize universal service goals in some poor and rural areas.

In order to realize the benefits of competition as soon as possible, the Commission must begin to address this issue now. The Commission is taking a first step in its Notice of Inquiry on high cost assistance, questioning whether subsidies should be based on proxies for cost, rather than actual cost, and whether subsidies should target consumers

who need assistance, rather than telephone companies that may be less than efficient.[4/] As the comments in this proceeding demonstrate, the question of who should receive subsidies and for what is complex and divisive.

Accordingly, while the Notice of Inquiry is a good start, the Commission must address universal service issues in a more comprehensive manner by initiating a Notice of Proposed Rulemaking ("NPRM") covering universal service issues. The comments received in the NOI, as well as those received in response to various petitions on the subject filed with the Commission last year, could serve as the basis for the NPRM. The Commission also should review proceedings in states such as Illinois, where the state commission and the LEC have eliminated subsidies from the LEC's rate structure without any negative effect on universal service penetration.[5/]

As part of its comprehensive reform effort, the Commission first should quantify the amount of alleged subsidies in the existing system. Estimates of the total annual subsidy have ranged from $4 billion to $20 billion. At a minimum, the Commission should develop a database that allows all interested parties to present their own analyses based on a common set of numbers. The Commission's recent data request to the LECs should enable the Commission to achieve this goal.[6/]

4/ Amendment of the Commission's Part 36 Rules and Creation of a Joint Board, Notice of Inquiry, CC Docket No. 80-266 (released August 30, 1994) ("NOI").

5/ See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket 80-266, Comments of Ameritech at 7-8 (filed October 28, 1994).

6/ Amendment of the Commission's Part 36 Rules and Establishment of a Joint Board, CC Order, CC Docket No. 80-266 (released December 1, 1994).

As to the collection and distribution of universal service funds, all telecommunications providers should be required to contribute toward the preservation of universal service in some manner. The Commission should ensure, however, that universal service contributions do not operate as a barrier to entry. First, the costs to be recovered should be a function of the Commission's factfinding, not LEC claims of need. Furthermore, the universal service fund should be administered by a neutral third party, rather than one controlled by LECs, and all carriers, including wireless providers and cable operators, should be eligible to receive subsidies for providing basic service to eligible customers. A number of carriers have proposed plans that would achieve these results, including the Universal Service Assurance plan recently proposed by Teleport Communications Group, and the Commission should move quickly to consider these proposals.

NUMBERING

Even as state laws prohibiting competition are removed, LECs still will retain a substantial competitive advantage over new entrants because they will control numbering resources. The experience of competitive access providers demonstrates that business and residential customers generally are unwilling to switch to a competitive local service provider if they also have to switch telephone numbers. Without complete number portability, LEC competitors must price their services at a level sufficiently low so as to compensate the customer for the tangible and intangible costs associated with changing telephone numbers.

Interim number portability mechanisms, such as remote call forwarding, are a partial, but inferior, solution.

Because the Commission has plenary control over numbering, number portability matters are best resolved at the federal level. As an initial step, the Commission should direct the Common Carrier Bureau to prepare a report on the implementation of number portability. The LECs have created the impression that complete portability is not technically or economically feasible, but there is little substantive evidence to support this claim. To the extent that full number portability is not a possibility in the near term, the Common Carrier Bureau also should examine the costs and benefits of interim solutions and ensure that LEC interconnection rates are discounted to reflect that an inferior form of portability is being provided. Moreover, the Commission should require that identical dialing sequences be required for similar calls carried on a LEC network, regardless of whether a call originates or terminates with a customer of a different local exchange carrier. The Commission's willingness to address these issues in a timely manner will reduce the need for regulatory intervention in the future and advance the cause of competition substantially.

The Commission can take other actions that reduce the competitive advantage LECs posses by virtue of their control over numbering. For instance, in most cases a CAP must purchase telephone numbers for new customers from the LEC. This added cost to the CAP, not borne by the LEC, is one more competitive advantage the LECs possess solely by virtue of their monopoly in the local exchange market. The Commission should transfer

responsibility for assignment and allocation of numbering resources away from the incumbent LEC to a neutral body. Until this change can be implemented, LECs should be required to provide telephone numbers to competitors on the same terms as the LEC uses them. Another artificial competitive advantage that must be eliminated is LEC control over directories, databases and services such as 911 and Telecommunications Relay Service. Competition will be hindered unless new entrants are provided access to these resources that is equivalent in price, functionality and quality to the access of the incumbent LEC.

REGULATION OF INCUMBENT LOCAL EXCHANGE CARRIERS

Regulation of telecommunications providers should correspond to their dominance in the market and their control over facilities essential to competition. Nondominant carriers, such as CAPs, should be subject to minimal regulatory requirements by the Commission because they have no ability to exercise market power and do not control essential facilities. There is substantial disagreement, however, on the crucial question of when streamlined regulation is warranted for dominant LECs.

In its Expanded Interconnection orders, the Commission allowed LECs greater pricing flexibility when a competitor first takes expanded interconnection service in a market. By permitting density zone pricing and volume and term discounts, the Commission granted LECs substantial pricing flexibility in the interstate access market. Unfortunately, this pricing flexibility puts new LEC competitors at a tremendous disadvantage because they must

price their services well below a LEC's lowest discounted rate if they hope to attract potential customers.

The Commission must take a different approach to future deregulation of the LECs. In the pending LEC price cap review, the Commission will consider when and how much additional pricing flexibility to give the LECs as competition increases. As Cox stated in its reply comments in that proceeding, the Commission must regulate LECs as dominant carriers until consumers have real and stable competitive choices and LECs no longer control essential facilities.[7/]

The approach advocated by the LECs in the price cap proceeding, which would provide substantial additional pricing flexibility based on the mere availability of alternative services, must be rejected for two reasons. First, this approach is entirely inconsistent with the Commission's experience and regulatory approach in the interexchange market. AT&T continues to be subject to regulation as a dominant carrier, even after more than 10 years of competition from MCI, Sprint and hundreds of other carriers. Although AT&T has lost market share, this disparate regulatory treatment has not prevented AT&T from achieving financial success over the past decade. At the same time, the rest of the interexchange industry has flourished because it has been protected from exercise of market power by AT&T.

7/ "Potential competition from cable operators and wireless providers is not a sufficient control on LEC prices to justify streamlined regulation. LEC arguments to the contrary cannot be reconciled with the realities of the market and must be rejected by the Commission." Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Reply Comments of Cox Enterprises (filed June 29, 1994).

Second, the LEC approach ignores the fundamental realities of the telephone industry. Because telephone services depend on the ability of the carrier to connect its customers to all other customers, a new entrant cannot provide service until it arranges for interconnection with LEC facilities and termination of calls to LEC customers. Moreover, unlike incumbents in the cable market, incumbent LECs control essential resources, such as telephone numbers, without which a competitor cannot offer a viable service.[8/] Therefore, as long as the incumbent LEC can raise the price of competing services by imposing costs on new entrants, the availability of an alternative service does not constrain the incumbent LEC's rates. In this case, additional pricing flexibility is not appropriate until the incumbent no longer is dominant and consumers view the competing service as a stable, realistic alternative to service provided by the LEC. Even then, however, regulation of LEC interconnection arrangements still may be necessary to ensure that LECs cannot use their control over essential facilities and resources to disadvantage competitors.

The Commission also should be sure that any changes made to the price cap rules do not undermine essential ratepayer and competitive protections. The Commission declined to adopt new cost allocation rules for video dialtone in part because it believes price cap regulation of LECs is sufficient to prevent anticompetitive LEC practices. While Cox is not convinced that this position is correct, it is certain that relaxation of the price cap rules would be an invitation for LECs to cross-subsidize their video dialtone networks. For

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8/ For example, cable operators with programming interests are required to make that programming available to unaffiliated program distributors on nondiscriminatory terms and conditions. See 47 U.S.C. § 548(b),(c).

example, the Commission must continue to require LECs to return excess earnings to their customers (through the sharing mechanism) and not allow them to use these revenues to cover the costs of upgrading facilities to provide video dialtone service.

CONCLUSION

Prompt Commission action in the four areas outlined above (interconnection, universal service, numbering and regulation of dominant LECs) will establish a foundation for the development of local exchange competition. Addressing only these four areas, however, is not enough. Commission actions in other proceedings also must be geared toward promoting fair local exchange competition. For instance, the Commission can promote entry of cable operators into the telephony market by adopting rules that encourage cable operators to upgrade facilities with the ability to provide two-way switched services. The Commission also can promote competition through its actions in other regulatory and legislative arenas. For example, the Commission should participate in state proceedings as an advocate for removal of entry barriers and forbearance of regulation of competitive telecommunications providers, and it should continue to urge Congress to adopt legislation that preempts state entry barriers and unnecessary regulation of nondominant carriers.

The introduction of competition for local telephone services unquestionably serves the public interest. As Chairman Hundt recently stated, "we are in a period of transition from monopoly to competition in all communications markets. For us, the election

of 1994 sends the clear message: Get on with it, and hurry up."[9/] By embarking on the path outlined in the paper, the Commission can begin the transition to competition in the local telephone market and ensure that consumers have the choice of providers and the variety of services that are available in every other telecommunications market.

9/ Speech by Reed E. Hundt, Chairman, Federal Communications Commission before the National Association of Regulatory Utility Commissioners (November 15, 1994).